
In the Matter of: :
: :
: : HUDBCA No. 04-A-CH-EE021
Crest Mortgage Company, : : FHA No. 491-7013214
: :
Petitioner : :
:

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DECISION AND ORDER

Petitioner was notified by Due Process Notice that, pursuant to 31 U.S.C. §§ 3716 and 3720, the Secretary of the U.S. Department of Housing and Urban Development (“HUD”) intended to seek administrative offset of any federal payments due to Petitioner in satisfaction of a delinquent and legally enforceable debt allegedly owed to HUD. The claimed debt is an amount that the Secretary claims is due under an indemnification agreement executed by Petitioner.

Petitioner has made a timely request for a hearing concerning the existence, amount or enforceability of the debt allegedly owed to HUD. The Administrative Judges of this Board have been designated to conduct a hearing to determine whether the debt

allegedly owed to HUD is legally enforceable. (24 C.F.R. § 17.152(c)). As a result of Petitioner's request, the Board temporarily stayed referral of the debt for offset.

Summary of Facts

By letter dated July 15, 2002, HUD requested that Petitioner execute an indemnification agreement following HUD's review of Petitioner's loan correspondent, HMS Mortgage, Inc. ("HMS"), that found "violations of HUD's underwriting requirements." (Supplement to Secretary's Statement, Exh. A, Supplemental Declaration of Glen Goodman, ("Supp. Goodman Decl.") Exh. C). HUD's letter identified six HMS' case files for construction less than one year old that were missing either the Subterranean Termite Treatment Builder's Certification and Guarantee Form NPCA-99a ("Form NPCA-99a") or a final inspection, both of which were required for evidence of property eligibility under HUD Handbook 4145.1, REV-2, ¶ 6-3A, Appendix 11, and Mortgagee Letters 99-03 and 97-40. (Supp. Goodman Decl., Exh. C, ¶ 1). A total of eight loan origination files, including the six loans previously mentioned, lacked other documents required for loan approval under HUD Handbook 4000.2, ¶ 5-10. (Supp. Goodman Decl., Exh. C, ¶ 3). As the sponsor of HMS, HUD's letter determined that even though HMS had primary responsibility for maintaining complete files, Petitioner was "also responsible to ensure that case files [were] complete." (Supp. Goodman Decl., Exh. C, ¶ 3). HUD found, consequently, that those noncompliant lending activities had "exposed HUD to an unacceptable level of risk." (Supp. Goodman Decl., ¶ 4).

Under the indemnification agreement enclosed with HUD's July 15, 2002 letter, Petitioner agreed to indemnify HUD for the six loans referenced in HUD's letter, which HMS had originated without either the required Form NPCA-99a or final inspection. (Supp. Goodman Decl., Exhs. A and C). The indemnification agreement required that Petitioner indemnify HUD in connection with those HMS' loans "for losses which have been or may be incurred...." (Supp. Goodman Decl., Exh. A ¶ 1.). The indemnification agreement provided that where "a HUD/FHA insurance claim has been paid in full and the property has been sold by HUD to a third party, the amount of indemnification is HUD's investment ... minus the sales price of the property." (Goodman Decl., Exh. A, ¶ 1. (c)). The indemnification agreement defined HUD's investment as including but not limited to:

the full amount of the insurance claim actually paid; any loss mitigation partial claims; all taxes and assessments paid or payable by HUD; all maintenance and operating expenses paid or payable by HUD, including costs of rehabilitation and preservation, loss mitigation, all sales expenses, where applicable, and any other expenses HUD may incur with respect to the property. (Goodman Decl., Exh. A, ¶ 1. (a)).

The indemnification agreement provided, in the alternative, that if HUD did not sell the property to a third party, Petitioner "will accept conveyance and indemnify HUD for its investment." (Goodman Decl., Exh. A, ¶ 1. (b)). Nothing in the indemnification

agreement required “HUD to advise or give the Petitioner the opportunity to sell, refinance, or otherwise make arrangements to cure such a debt....” (Supp. Goodman Decl., ¶ 9).

In response to HUD’s July 15, 2002 letter, Petitioner’s August 28, 2002 letter returned to HUD the executed indemnification agreement without objection. (Supp. Goodman Decl., Exh. B). Petitioner had reviewed the files for the six loans referenced in the indemnification agreement and found that five loan files had no Form NPCA-99a and could not locate the final inspection for the sixth loan file. (Supp. Goodman Decl., Exhs. A and B). Petitioner acknowledged that its “DE Underwriter ... apparently ... was not current on the change stated in Mortgage[e] Letter 99-03....” (Supp. Goodman Decl., Exh. B). Petitioner’s letter advised HUD that the underwriter responsible for those loans “has been terminated and no longer has any association with Crest Mortgage Company as well as any sponsor relations with HMS Mortgage.” (Supp. Goodman Decl., Exh. B).

Pertinent to this matter is the HMS’ loan referenced in the indemnification agreement under FHA case number 491-7013214 (“Harris loan”). (Supp. Goodman Decl., Exh. A). HUD’s July 15, 2002 letter noted that the Harris loan file did not have a Form NPCA-99a, and advised Petitioner that “[a] claim ha[d] been filed in the Harris case.” (Supp. Goodman Decl., Exh. C, ¶ 1). The Harris loan was insured against nonpayment under Title II of the National Housing Act, 12 U.S.C. § 1707, *et seq.* (Secretary’s Statement, (“Secy. Stat.”) ¶ 2). The mortgagor defaulted on the Harris loan on June 1, 2001, and the Secretary paid the insurance claim on April 20, 2002. (Secy. Stat., Exh. A, Declaration of Glen Goodman, (“Goodman Decl.”) ¶ 4). The sale of the property took place on July 26, 2002 for a sales price of \$110,419.00. (Goodman Decl., ¶¶ 4-5).

The “as is” appraised value of the property financed by the defaulted Harris loan was \$120,000.00, but the resale of the property for “\$110,419.00 was in accordance with HUD policy and regulation.” (Supp. Goodman Decl., ¶ 8). The property was “on the market for one month and an offer was accepted for an amount that was within HUD defined ‘reasonable amount of appraised value’ as per [HUD’s] REO contract.” (Supp. Goodman Decl., Exh. D). The sale of the property took into consideration HUD’s “‘holding costs’ and risk to the property with it being vacant.” (Supp. Goodman Decl., Exh. D).

By letter dated December 16, 2002, HUD directed Petitioner to indemnify HUD for its loss on the Harris loan in the amount of \$50,727.40, the difference between the sales price, \$110,419.00, and HUD’s investment. (Goodman Decl., Exh. B). HUD’s investment included: insurance payments, \$142,512.08 (Part A) and \$6,619.08 (Part B); taxes, \$2,154.02; maintenance and operation, \$6,068.47; and sales expenses, \$3,792.75. (Goodman Decl., ¶ 5). Petitioner is delinquent in paying HUD the amount claimed under the indemnification agreement for the Harris loan. (Goodman Decl. ¶ 6). Petitioner is indebted to HUD for the following amounts: \$50,727.40, as the unpaid principal balance as of March 31, 2004; \$1,305.54 as the unpaid interest on the principal balance at 2% per annum through March 31, 2004; and, interest on the principal balance from April 1, 2004 at 2% per annum. (Goodman Decl., ¶ 6).

Discussion

31 U.S.C. §3716 provides federal agencies with the remedy for collecting debts owed to the United States Government. The Secretary has filed a Statement and a Supplemental Statement with documentary evidence in support of his position that Petitioner is indebted to HUD in a specific amount. Petitioner challenges both its liability and the sale of the property under the terms of the indemnification agreement.

Petitioner contends that “[i]n the interest of fairness ... the party bearing primary responsibility in the matter should be HMS.” (Petitioner’s Letter dated May 13, 2004 (“Pet Ltr.”)). Petitioner cites no legal authority for such a conclusion, and the Board finds to the contrary. Petitioner was HMS’ sponsor. A sponsor is responsible “to the Department for the actions of its Loan Correspondent(s) in originating insured mortgages.” HUD Handbook 4060.1, REV-1, ¶ 3-4. The sponsor “performs the loan underwriting function on behalf of the Loan Correspondent.” Id.

The Board, consequently, finds no merit to Petitioner’s contention, regarding HUD Handbook 4060.1, REV-1, ¶ 3-4, that there was “a large stretch of those guidelines to conclude that [Crest Mortgage Company] bears any responsibility for losses associated with performance of the loan...” (Pet. Ltr.) There is no dispute that Petitioner was the sponsor for HMS. Petitioner was responsible to HUD for its deficient underwriting of HMS’ loans as well as HMS’ noncompliant lending practices.

Petitioner argues that it was able “fill any voids from [its] retained records.... [t]he point being there was no real deficiency that impacted the legitimacy and/or performance of the loan.” (Pet. Ltr.). Petitioner’s argument is not persuasive. A request for indemnification is “in lieu of referring the matter to the Mortgage Review Board.” HUD Handbook 4004.4, REV-1, CHG-2, ¶ 5-8. Referral to the Mortgage Review Board may occur when “[v]iolations of HUD’s requirements ... significantly increase the Department’s risk and were caused by fraud or serious negligence....” Id. This Board has found that HUD may “request indemnification from the mortgagee for violations of HUD’s requirements on the part of the mortgagee that significantly increase HUD’s risk.” Indigo Mortgage Services, Inc., HUDBCA No. 95-C-132-MR4 (May 12, 1995)(WESTLAW) at 8.

HUD reasonably determined that it had been exposed to an unacceptable level of risk because of Petitioner’s lack of care in underwriting HMS’ loans without the proper documentation required by HUD. Those missing documents were necessary for evidence of property eligibility and loan approval. Petitioner has not refuted the Secretary’s evidence that HMS improperly originated loans and that Petitioner’s underwriter failed to notice those deficiencies. To the contrary, Petitioner’s August 28, 2002 letter conceded the deficient work of its underwriter in connection with those loans and executed the indemnification agreement without objection. Petitioner was responsible for causing an unacceptable level of risk to HUD, and the Board finds that HUD’s request for Petitioner to execute the indemnification agreement was reasonable under the circumstances. Petitioner is liable to HUD under that agreement for HUD’s loss in connection with the Harris loan.

Petitioner contends that the “sales price of \$110,419.00 seems most inappropriate.” (Pet. Ltr., Exh. 1, Petitioner’s letter dated January 16, 2003 (“Pet. Ltr., Exh.1”)). Petitioner’s letter cites no legal authority that would have precluded the sale of the property. The Secretary has provided evidence that the sale of the property was the result of a business decision consistent with applicable HUD policy and regulation. That decision making process considered the costs of holding the property and the risk of letting it sit vacant. Petitioner has offered no documentary evidence to refute HUD’s evidence. Absent such evidence, the Board finds that the sales price was reasonable and that HUD has properly computed its loss based on that sales price.

Finally, Petitioner argues that a “repurchase of the loan would seem to have presented a better option for Crest or HMS, given that opportunity.” (Pet. Ltr., Exh. 1). HUD was under no obligation under the indemnification agreement to repurchase the loan. An indemnification agreement gives “HUD the right to decide whether to sell the property to a third party or convey to the Petitioner.” First Millennium Mortgage Corp., HUDBCA No. 04-K-CH-EE023 (September 22, 2004) at 3. The sale of the property was consistent with the terms of the indemnification agreement. Petitioner’s debt is past due and enforceable.

Order

Upon due consideration of the entire record of this proceeding, I find that the debt which is the subject of this proceeding is legally enforceable against Petitioner in the amount claimed by the Secretary.

The Order imposing the stay of referral of this matter to the Internal Revenue Service or to the U.S. Department of the Treasury for administrative offset is vacated. It is hereby ORDERED that the Secretary is authorized to seek collection of this outstanding obligation by means of administrative offset of any Federal payments due to Petitioner.

H. Chuck Kullberg
Administrative Judge

October 29, 2004